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No. 03-1034

In the Supreme Court of the United States

ESTATE OF BURTON W. KANTER, ET AL.,

Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

REPLY BRIEF FOR THE PETITIONER

PHILIP ALLEN LACOVARA
Mayer, Brown, Rowe & Maw LLP
1675 Broadway
New York, NY 10019

STEPHEN M. SHAPIRO
Mayer, Brown, Rowe & Maw LLP
190 South LaSalle Street
Chicago, IL 60603

RANDALL G. DICK
Law Office of Randall G. Dick
744 Montgomery Street
Third Floor
San Francisco, CA 94111

RICHARD H. PILDES
Counsel of Record
New York University School of Law
40 Washington Square South
New York, NY 10012
(212) 998-6377

N. JEROLD COHEN
TERESA WYNN ROSEBOROUGH
MATTHEW J. GRIES
Sutherland Asbill & Brennan LLP
999 Peachtree Street N.E.
Atlanta, GA 30309

Counsel for Petitioners

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1. The Issues Are Of Exceptional National Importance. The government attempts to portray this case as a run-of-the-mill dispute despite the fact that it involves a circuit split and a remarkable practice of judicial secrecy that raises serious due process and statutory issues. The Tax Court practice at issue has created a furor in the Tax Court bar and generated national legal concern. The government considers it irrelevant (Opp. at 6, 14) that the Tax Court affirmatively misleads the Courts of Appeals and taxpayers by manipulating the record to hide conflicts between the recommended factual findings of its trial judges (STJs) and the ultimate findings of the Tax Court. The Courts of Appeals routinely review "credibility" and "intent" findings in Tax Court decisions without knowing whether those published findings conceal – as the government does not dispute is true here – a complete contradiction between the trial judge and the Tax Court judge who, having heard none of the witnesses, nonetheless overturns the trial judge's findings and credibility judgments.

Neither the Tax Court's rules nor anything the government points to publicly explains that the Tax Court asserts the power to secretly overturn its trial judges' recommended findings without the record reflecting that reality. The Courts of Appeals, legally required to determine whether Tax Court findings are "clearly erroneous," are denied knowledge of when the Tax Court's published findings conflict with those filed by the trial judge. The appellate courts have no basis for comparing the findings, inferences, and conclusions in the trial judge's report and the Tax Court's ultimate decision. The straightforward legal question presented – which the government's brief obscures – is whether non-disclosure of the trial judge's report violates due process, Congress's repeated mandate that all Tax Court reports and findings be public, or the statutory right to appellate review based on the full record.

2. There Are No Facts In Dispute. The government does not dispute that the issue of secret STJ reports is a recurring one in a large category of important tax cases every year. It does not deny Kanter's showing that STJs are used in 50-89 cases a year involving the process at issue here, or that the Tax Court keeps secret the STJ reports in every one of these cases. The government does not disagree that these secret STJ reports affect massive amounts in tax liabilities, including the more than $30 million at issue here and the $1.5 billion at issue in *Freytag v. Commissioner*, 501 U.S. 868, 871 n.1 (1991). Nor does the government deny that these STJ reports were, for many years, routinely made available.

With respect to this case, the government does not dispute what three judges of the Tax Court have reported: that the experienced STJ who alone heard all the witnesses, actively questioned most of them, and then filed a detailed, lengthy opinion – after more than four years of reviewing the case – found that the taxpayers had testified credibly; that they were not personally liable for the monies at issue in this appeal *at all*, let alone for fraud; and that all of the income was properly reported for tax purposes by the entities to which it was paid.

The government also does not deny what these three judges of the Tax Court further reported: that the Tax Court judge, who heard none of the witnesses, re-wrote the STJ's opinion, made an "outright rejection"[1] of the STJ's credibility findings, and completely changed the STJ's "findings relating to credibility and fraud."[2] Thus, the government does not deny that, in this multi-million-dollar dispute, a head-on contradiction exists between the trial

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[1] *Declaration of Attorney Randall G. Dick* ¶ 7, Seventh Cir. App. 250-252; see also Pet. App. 73a n.1 (*Declaration* cited in Judge Cudahy's dissent).

[2] *Id.* at ¶ 5.

judge's recommended findings and the Tax Court's ultimate findings. Nor does the government deny that the Courts of Appeals were asked to review this decision without access to the basis for these diametrically opposed conclusions.

3. Secret Trial Judge Reports Violate Due Process. The government offers three reasons that secret STJ reports purportedly do not violate due process or federal statutes. First, the government dismisses the STJ's report as of no "relevance" because it does not embody the final "decision" of the Tax Court. Opp. at 12, 14. This is a remarkable assertion. Even though the report is not the final disposition of the case, the Tax Court's own rules require the STJ to file this report; those rules further require that the Tax Court "shall" give "[d]ue regard" to the fact that the STJ "had the opportunity to evaluate the credibility of witnesses" and "shall" presume correct the STJ's findings of fact. Tax Ct. R. 183(b), (c). These are legal mandates to which the Tax Court is obligated to adhere. See, *e.g.*, *Service v. Dulles*, 354 U.S. 363, 388 (1957). The Courts of Appeals are in direct conflict on exactly how strong Rule 183's constraint is on the Tax Court's power to reverse its trial judges, but there is no dispute that Rule 183 gives the STJ's report direct legal significance, whatever the exact quantum of deference required. Further, as Judge Cudahy explained below, to engage in proper appellate review, the courts must know whether a credibility "finding" comes from the trial judge.

The STJ's reports are initial *judicial* findings of fact, like those of federal magistrate judges and court-appointed special masters. The STJs are *judges*. Their reports are not law clerk memoranda or similar internal communications within a judge's chambers. Internal communications do not enjoy a legal presumption of correctness, as do the STJ's findings; law clerks and similar employees are not charged with the responsibility to hear witnesses, rule on admissibility of evidence, make credibility determinations, or submit detailed formal opinions. The government's

argument that the trial judge might have changed his mind by the time of the Tax Court's ultimate decision is beside the point, for it is the Rule 183 report, which must be filed, to which the Tax Court is required to give deference.

The government does not disagree with Kanter's showing that no other court or even administrative agency in the federal system is permitted to conceal such initial findings and credibility judgments. Indeed, as Judge Cudahy wrote in dissent, "I can think of no single item of *more* significance in evaluating a Tax Court's decision on fraud than the unfiltered findings of the STJ who stood watch over the trial." Pet. App. 93a (emphasis added). The government does not explain how appellate courts can perform proper appellate review, especially where intent and credibility are critical, absent complete information regarding fundamental conflicts – like that between no tax liability and fraud – between trial judge and Tax Court findings.

Second, the government repeatedly argues that Kanter "misperceives" the allocation of responsibility between STJs and Tax Court judges. Opp. at 7. But Kanter's petition consistently recognizes that STJs make initial or recommended findings. Kanter does not argue that the STJ's may decide cases, but only that their legally-mandated findings must be included in the record. There is nothing novel in this. What is novel is that the Tax Court, unlike any other federal judicial or administrative body, refuses to release the initial STJ findings so that the Courts of Appeals can engage in proper appellate review.

The government's lecture about divisions of responsibility under 26 U.S.C. § 7443A(b)(4) and (c) thus obscures the essential legal point: STJ reports must be part of the record on review. The findings of administrative law judges and other initial hearing officers must be part of the record under the Administrative Procedure Act, even when an agency has de novo fact-finding power. 5 U.S.C. § 557(c)

("All decisions, including initial, recommended, and tentative decisions, are a part of the record * * *."). Kanter's simple claim is that due process and federal statutes require at least the same of the Article I Tax Court – particularly because the Tax Court is required to presume the STJ's findings to be correct.

Third, the government exaggerates the narrow claim Kanter is making. Kanter does not "challenge the authority of the Tax Court, without public disclosure, to communicate or collaborate with a special trial judge about a case after the judge submits an 'original' report to the Chief Judge under Rule 183(b)." Opp. at 14. Kanter argues only that, whatever communications take place, the record must include the Rule 183 Report with its recommended findings.

4. The Circuits Are In Conflict. The government attempts to avoid the direct conflict that exists. The D.C. Circuit holds that the Tax Court's own rules permit it to overturn STJ findings only when "clearly erroneous." *Stone v. Comm'r*, 865 F.2d 342, 344 (D.C. Cir. 1989). In stark contrast, the decision below held that these rules do not require "any particular level of deference" at all to the STJ's findings. This conflict over the reviewing power of the Tax Court was reserved in *Freytag*. 501 U.S. at 874 n.3. Its resolution is critical to the proper structure of Tax Court adjudication. Both the D.C. Circuit and the Seventh Circuit interpreted the identical language in the relevant Tax Court rules: "Due regard shall be given to the circumstance that the commissioner [since re-named the special trial judge] had the opportunity to evaluate the credibility of witnesses; and the findings of fact recommended by the commissioner shall be presumed to be correct." Tax. Ct. R. 182(d), 60 T.C. 1150 (1973), renumbered as current Tax Ct. R. 183(c). But the circuits reached directly conflicting results concerning the legal effect of this language.

The government attempts to distinguish the cases on the ground that the current Rule dropped the earlier requirement that the commissioner's (or STJ's) report be served on the parties. But that procedural modification regarding the report's *disclosure* cannot possibly affect the plain meaning of the unaltered legal text concerning the standard of review. The plain language of Rule 183 continues, in identical terms, to require the Tax Court to adhere to the "presumed correct" and "due regard" standards. Withholding the STJ's report no more changes the review role of the Tax Court than non-publication of District Court opinions would change the review role of the Courts of Appeals. The government cannot point to any history that suggests the Tax Court *intended* to change its review role, but even such evidence would not be enough to alter the meaning of the Rule's unchanged text. See *Bedroc Ltd., LLC v. United States*, 541 U.S. __ (2004) (slip op. at 6-7). Moreover, the Seventh Circuit viewed its "no deference at all" holding as compelled by the statutory structure of the Tax Court (Pet. App. 8a) – a view in direct conflict with the D.C. Circuit's interpretation of the statutes. This conflict on the review role the statutes permit or require the Tax Court to play does not turn on whether the Tax Court's internal rule has been modified to deny access to the STJ report.

There also is no doubt that *Stone* continues to govern in the D.C. Circuit. Judge Williams in *Stone* noted that the Tax Court had used language with a "well-established meaning" and that "until the [tax] court adopts new language, it must hew to the meaning of what it has said." *Stone*, 865 F.2d at 347. The Tax Court has not adopted any such new language. The D.C. Circuit has never questioned *Stone*, and as the government concedes (Opp. at 17) has recently endorsed *Stone*. *Landry v. FDIC*, 204 F.3d 1125, 1133 (D.C. Cir. 2000) (distinguishing FDIC's de novo fact-finding powers from limitation of Tax Court to "clearly erroneous" review of its STJs). Indeed, *Landry* expressly cited current Rule 183(c)

(*id.*), which makes clear that the D.C. Circuit continues to adhere to *Stone*. The government suggests the conflict is "moot" because the Tax Court said it adopted "the opinion" of the STJ. Opp. at 17. But the government does *not* argue (because it would not be true) that the Tax Court adopted the original STJ report. *That* is the report to which Rule 183 requires deference, whether under the "clearly erroneous" standard or some lesser one, and the conflict over the Rule's meaning remains live.

5. The Tax Court Violates Congress's Commands. Congress has legislated numerous times, for at least 80 years, to attempt to ensure full transparency, accountability, and fairness in tax proceedings. Yet unlike other judicial bodies, the Tax Court regularly refuses to disclose legal decisions and actions it takes. That is true concerning not only the practice at issue, but other Tax Court practices as well. See, *e.g.*, Leandra Lederman, *Tax Court S Cases: Does the "S" Stand for Secret?*, 79 TAX NOTES 257 (April 13, 1998) (criticizing as illegal the Tax Court's denial of public access to decisions in small-tax cases). Congressional statutes variously provide that "all reports," "all evidence," and all "findings of fact, opinions, and memorandum opinions" in tax proceedings must be disclosed. 26 U.S.C. §§ 7461(a), 7459(b). These broadly-worded statutes were specifically enacted to regularize tax court proceedings and rid them of secretive processes. The Tax Court's own rules numerous times deem the product of the STJs to be "reports" that must contain "findings of fact." Tax Ct. R. 183(b), (c). The statutory disclosure mandates for "all reports" and "findings of fact" thus apply to the STJ's reports. At the very least, these statutes should be construed to require disclosure to avoid the substantial constitutional issues otherwise presented. Certiorari is warranted to address the Tax Court's repeated attempts to operate outside the system of transparency that Congress has required and under which all other federal judicial and administrative bodies operate.

This issue was raised below and the lower court expressly passed on it; indeed, Judge Cudahy dissented on this issue. Pet. App. 7a, 9a, 11a, 80-83a, 96a. The issue is therefore properly presented. See *United States v. Williams*, 504 U.S. 36, 40-41 (1992). See also Appellant's Petition for Rehearing and for Rehearing En Banc, at 13; Appellant's Reply Brief, at 9 n.3.

These statutes, and the relevant due process principles that animate them, should also be construed to reflect the common-law right and legal presumption that favors public disclosure of all judicial records and documents on which the decision-making tribunal is legally required to rely. See, *e.g.*, *Nixon v. Warner Communications, Inc.*, 435 U.S. 589, 597 (1978). The government rejects this principle on the theory that the Tax Court was once an executive agency, like the ancient English "court of exchequer." But in another important effort to ensure regularity and fair administration of the tax system, Congress in 1969 established the United States Tax Court as an Article I "court of record." 26 U.S.C. § 7441. Congress granted the Tax Court additional judicial powers, such as the power to punish contempt, and conclusively established that the Tax Court would "no longer be an independent agency in the executive branch." HAROLD DUBROFF, THE UNITED STATES TAX COURT: AN HISTORICAL ANALYSIS 213 (1979).

The Tax Court is now a judicial institution of the United States. See *Freytag*, 501 U.S. at 891. Legal presumptions about fair and proper judicial administration, such as public accessibility to decisional documents, apply to it as to other federal judicial institutions. See also Brief *Amicus Curiae* of Sen. David Pryor *et al.* in Support of Petition for Certiorari in *Ballard v. Commisioner*, No. 03-184, at 8-10 (discussing Omnibus Taxpayer Bill of Rights, 102 Stat. 3342, 3731). Indeed, the government cannot have it both ways. If instead the Tax Court were somehow deemed an executive agency, it would have to comply with the APA. But the APA leaves no

doubt that the reports of hearing officers like STJs must be included in the record on review. See *supra* at 4-5.

The appellate review statute (26 U.S.C. § 7482(a)(1)) also requires the Courts of Appeals to review "decisions" of the Tax Court "in the same manner and to the same extent" as decisions of the district courts in non-jury civil actions. The government argues this statute does not require disclosure of the STJ report because appellate review is only of the "decision" of the Tax Court itself. Kanter, of course, fully recognizes that the STJ's report is not itself the final decision of the Tax Court. Kanter's argument is that proper appellate review *of the Tax Court's decision* requires that the record include the presumptively-correct STJ report. The government does not explain how the Courts of Appeals can conduct the statutorily-required review if the record does not reflect that, as in this case, the Tax Court has overturned the findings and credibility judgments of the trial judge. Just as the reports of magistrates, bankruptcy judges, and special masters are part of the record on review of decisions of district courts (see Pet. at 16-17), the reports of STJs must be part of the record to ensure proper appellate review.

6. The STJ Found Petitioner Not Liable. The government's tendentious use of the term "kickbacks" reveals precisely why due process must enable the appellate courts to review the complete record. Although the government seeks to poison the Court's exercise of its discretion by suggesting that Kanter concealed some kind of illegal income, all income from the transactions at issue was fully reported for tax purposes by the entities to which it was paid. The dispute is whether the income should have been reported by Kanter personally, as the government claimed, or by the entities that actually received the monies, as Kanter, one of the leading tax lawyers and writers in the country, claimed. An experienced judge, sitting since 1985, found that Kanter had properly paid all taxes, testified credibly, and was not liable for taxes, let alone for fraud. Even without the

STJ's report, the Fifth Circuit has already overturned, as clearly erroneous, the Tax Court's finding of fraud with respect to one of the other taxpayers involved. *Estate of Lisle v. Comm'r*, 341 F.3d 364 (5th Cir. 2003).

7. Numerous Commentators Have Concluded That Secret STJ Reports Violate Due Process And Federal Law. Since this litigation revealed that the Tax Court asserts the power to reverse its trial judges findings without the record reflecting that fact, there has been an outpouring of commentary in the professional journals. Virtually all this commentary strongly criticizes the Tax Court and argues that its secret practices violate due process and federal law. See, *e.g.*, Eric Winwood, *The Reclusive Report: The Tax Court Denies Due Process By Not Disclosing Special Trial Judge Reports To Litigants*, 2004 FED. CTS. L. REV. 3; Leandra Lederman, *Transparency and Obfuscation in Tax Court Procedure*, 102 TAX NOTES 1539, 1541 (March 22, 2004) (non-disclosure of the STJ report improperly "shields the [tax] court from accountability"); Gerald A. Kafka & Jonathan Z. Ackerman, *Fact-Finding in the Tax Court: Access to Special Trial Judge Reports*, 91 TAX NOTES 639, 642 (April 23, 2001) ("There seems to be little justification for the Tax Court to shroud its judicial processes from the public and the parties to a greater extent than any other federal court."); Cornish F. Hitchcock, *Public Access to Special Trial Judge Reports*, 2001 TAX NOTES TODAY 199-41 (Oct. 12, 2001) (non-disclosure of STJ report violates common-law and constitutional rights of access to judicial documents). See also Marcia Coyle, *Secrecy in Tax Court Proceeding Challenged*, NATIONAL LAW JOURNAL, March 15, 2004, at 1 (noting national significance of issue). This extensive, critical commentary confirms that this case poses important issues of national concern that warrant the grant of certiorari.

Respectfully submitted.

PHILIP ALLEN LACOVARA
Mayer, Brown, Rowe & Maw LLP
1675 Broadway
New York, NY 10019

STEPHEN M. SHAPIRO
Mayer, Brown, Rowe & Maw LLP
190 South LaSalle Street
Chicago, IL 60603

RANDALL G. DICK
Law Office of Randall G. Dick
744 Montgomery Street
Third Floor
San Francisco, CA 94111

RICHARD H. PILDES
Counsel of Record
New York University School of Law
40 Washington Square South
New York, NY 10012
(212) 998-6377

N. JEROLD COHEN
TERESA WYNN ROSEBOROUGH
MATTHEW J. GRIES
Sutherland Asbill & Brennan LLP
999 Peachtree Street N.E.
Atlanta, GA 30309

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